UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

In re:

GREGORY ELIOPOULOS, f/k/a GREGORY G. GENO, — Chapter 7, Case No.: 03-16950

Debtor.

NORTHERN FEDERAL CREDIT UNION, — Adv. Pro. No.: 04-90063

Plaintiff,

v.

GREGORY ELIOPOULOS,

Defendant.

APPEARANCES:

Anthony Inserra, Esq.
Attorney for the Debtor/Defendant
531 Washington Street
Suite 3401
Watertown, NY 13601

Antonucci Law Firm — David P. Antonucci, Esq.
Attorneys for the Plaintiff
12 Public Square
Watertown, NY 13601

Hon. Robert E. Littlefield, Jr., United States Bankruptcy Judge

Memorandum-Decision and Order

Currently before the court is the request of Mr. Inserra, counsel for Gregory Eliopoulos (the "Debtor") for an award of counsel fees and costs as sanctions[1] pursuant to Federal Rule of Bankruptcy Procedure (hereinafter "Rule") 9011 and 11 U.S.C. § 105 in connection with the dismissal of an adversary proceeding commenced by Northern Federal Credit Union (the "Plaintiff") against the Debtor pursuant to

[1] As used herein, the term "sanctions" refers only to attorney's fees and costs. Directives of a nonmonetary nature and monetary penalties paid into the court, both of which are available under Federal Bankruptcy Rule 9011(c)(2), are not being considered in this case.

11 U.S.C. § 727. As more fully explained hereafter, the court reserves its ruling on this matter and, on its own initiative, issues the within show cause order directing the Plaintiff and its counsel, Mr. Antonucci, to show cause why they should not be sanctioned pursuant to 11 U.S.C. § 105 and/or Rule 9011(b)(1), (2) and (3).

Jurisdiction

The court has jurisdiction over the parties and subject matter of this core proceeding pursuant to 28 U.S.C. §§ 157(a), 157(b)(1), (b)(2)(J), and 1334(b).

Factual and Procedural Background

On October 20, 2003, the Debtor filed an individual voluntary petition under Chapter 7 of the United States Bankruptcy Code (11 U.S.C. §§ 101 - 1330) (the "Code"). The Debtor simultaneously filed his list of creditors, schedules, and statements required by Rule 1007. The Debtor's schedules reveal the following information: the Debtor owns no real property; his total assets consist of personal property valued at $13,177.50; his liabilities consist of $14,505.21 in secured debt, and $21,402.63 in unsecured debt; through his employment as a laborer, the Debtor nets monthly income of $858.10; and his monthly expenses total $1,588.90, which does not include any line items for rent or mortgage, home maintenance, or homeowner's or renter's insurance.

The Plaintiff is a creditor in the case holding an unsecured nonpriority claim in the amount of $3,420.33. On January 9, 2004, after an initial examination of the Debtor at the § 341 meeting of creditors on December 10, 2003, the Plaintiff filed a motion pursuant to Rule 2004 for an order allowing a Rule 2004 examination of the Debtor. According to the Plaintiff, the Debtor's Schedules "I" and "J" were replete with inaccuracies because the Debtor had not fully disclosed the income and expenses of his fiancee, with whom he resides. That motion was granted by order issued February 10, 2004, and the Plaintiff further examined the Debtor at the Rule 2004 examination held on March 2, 2004 ("2004 Examination"). Shortly thereafter, on March 15, 2004, the Plaintiff filed a Complaint to deny the Debtor's general discharge pursuant to Code

§ 727.[2] The Debtor filed an Answer on March 29, 2004, denying the substantive allegations of the Complaint.

On April 12, 2004, after the court's issuance of a Scheduling Order on March 30, 2004, the Debtor filed a motion to dismiss the Complaint. This is where Mr. Inserra's request for sanctions originated. The motion was heard on the court's regular motion calendar on May 6, 2004, and the court, by oral ruling, dismissed the adversary proceeding with prejudice. The court reserved its decision on attorney's fees, however, to allow the parties sufficient time to file memoranda of law.

After consideration of the parties submissions, the court is persuaded that sanctions may be appropriate in this case. Because Rule 9011(c)(1)(B) requires that the court give parties who are subjected to potential sanctions specific notice of the conduct alleged to violate Rule 9011(b), this Memorandum-Decision and Order shall serve as the requisite notice for impositions of sanctions in this proceeding.

Arguments

The Debtor argues that this proceeding is the result of "a particularly aggressive creditor" who, through counsel, advanced an argument that had very little chance of success. (Debtor's Mem. of Law at 5.) He contends that if the Plaintiff, or its counsel, had properly analyzed its burden of proof under Code

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[2] The Complaint was not pled with specificity, but referred generally to Code § 727(a). The Complaint sets forth only one cause of action, although the Plaintiff's allegations include that the Debtor's schedules were "false" and "designed with the intent to hinder, delay, or defraud creditors" (Complaint ¶ 19), language derived from Code § 727(a)(2), and the making of a false oath (Complaint ¶ 20), which corresponds to Code § 727(a)(4)(A). Throughout the pre-trial proceedings, the Plaintiff also argued that the Debtor had concealed certain transfers or gifts made to his fiancee. The specific Code provisions, however, do not appear anywhere in the Plaintiff's pleadings or submissions. In its memorandum in opposition to the Debtor's request for attorney's fees, the Plaintiff cites certain case law purportedly justifying its filing of the Complaint, including *Williamson v. Fireman's Fund Ins. Co.,* 828 F.2d 249 (4th Cir. 1987), *In re Glickman,* 64 B.R. 616 (Bankr. S.D.Fla. 1986), and *McCracken v. Emmett (Matter of Emmett)*, 16 B.R. 656 (Bankr. S.D. Fl. 1981). These cases collectively refer to Code §§ 727(a)(2) and (4)(A).

As discussed *infra*, the Plaintiff's choice of relief is particularly relevant to a determination of sanctions under Rule 9011. For purposes of clarification, the court notes, after review of the parties' pleadings and submissions, and of the tape recording from the May 6, 2004 hearing on the Debtor's motion to dismiss, that the Plaintiff commenced and prosecuted this adversary proceeding under Code § 727(a)(4)(A) ("false oath or account"), not Code § 727(a)(2) (concealment or transfer of assets).

§ 727(a) before filing the Complaint, it would have been obvious that it could not prevail in this adversary proceeding.[3] He further argues that policy favors the imposition of sanctions in this case because the tactics used by the Plaintiff and its counsel force innocent debtors to endure "months of delay and mounting legal fees in order to obtain what was once an affordable second chance." (*Id.* at 6.) For example, Mr. Inserra estimates that the legal fees in this case are approximately two times the amount of the outstanding debt.[4] Finally, the Debtor states that if the Plaintiff had acted reasonably under the circumstances, its inquiry would have ended without further legal action in December of 2003 when the Trustee closed the § 341 meeting of creditors.

The Plaintiff responds with three separate arguments: first, the Plaintiff contends that the application for sanctions is premature because "no order exists dismissing the action or granting summary judgment" (Pl.'s Mem. of Law, Point I); second, the Plaintiff argues that no statutory authority exists for awarding attorney's fees, including Code § 727, in deviation from the "American Rule" (*Id.*, Point II); and third, the Plaintiff argues that sanctions are not warranted as a matter of law because the action was commenced in good faith (*Id.,* Point III). In support of the third point, the Plaintiff states that the Complaint was warranted by the Debtor's "appearance of impropriety" and "the Debtor's own conduct" (*Id.* at 6). Specifically, the Plaintiff refers to unlisted "income" the Debtor received from his fiancee, and *de facto* "gifts" given by the Debtor to his fiancee, including an automobile. The Plaintiff cites to *Williamson*, 828 F.2d 249, 251 (4th Cir. 1987), as support for its position that a false oath is made by a debtor when he (1) fails to disclose a joint bank account that is maintained with a fiancee in response to a specific question on the Statement of Financial Affairs asking for disclosure of all bank accounts, or (2) fails to reveal gifts made within the

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[3] The Debtor's memorandum of law in support of sanctions references Code §§ 727(a) and 523. Because Code § 523 does not apply to this proceeding, the court will not address the Debtor's points thereunder.

[4] It should be noted that the exact amount of sanctions to be awarded, if any, is not presently before the court.

relevant time period in response to a question asking him to identify all gifts made during the year preceding the bankruptcy filing. In sum, the Plaintiff argues that the Complaint was filed for the legitimate purpose of objecting to the Debtor's discharge, and that the action was meritorious under the body of case law relating to Code § 727.

Discussion

I. Rule 9011 Sanctions

Ordinarily, a determination that the debtor lacked fraudulent intent would end a discharge objection proceeding under Code § 727(a)(4)(A). In this case, however, the court must determine whether the adversary proceeding was so unwarranted as to merit sanctions pursuant to Rule 9011 and Code § 105. As the logical starting point, the court first turns to Rule 9011.

Rule 9011 provides a statutory exception to the traditional "American Rule" that "the prevailing party is ordinarily not entitled to collect a reasonable attorneys' fee from the loser." *Alyeska Pipeline Service Co. v. Wilderness Society,* 421 U.S. 240, 247 (1975). The pertinent sections of Rule 9011 read:

> **(b) REPRESENTATIONS TO THE COURT.** By presenting to the court (whether by signing, filing, submitting, or later advocating) a petition, pleading, written motion, or other paper, an attorney or unrepresented party is certifying to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances, –
>
> (1) it is not being presented for an improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;
>
> (2) the claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law;
>
> (3) the allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and
>
> (4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on a lack of information or belief.
>
> **(c) SANCTIONS.** If, after notice and a reasonable opportunity to respond, the court determines that subdivision (b) has been violated, the court may, subject to the conditions stated below, impose an appropriate sanction upon the attorneys, law firms, or parties that have violated subdivision (b) or are responsible for the violation.
>
> (1) How initiated.
>
> . . . .
>
> (B) On Court's Initiative. On its own initiative, the court may enter an

> order describing the specific conduct that appears to violate subdivision (b) and directing an attorney, law firm, or party to show cause why it has not violated subdivision (b) with respect thereto.

Fed. R. Bankr. P. 9011. Here, the Complaint meets the preliminary requirement of Rule 9011 that there be a signed pleading, motion, or other document as the foundation for the sanctionable conduct.

Now, the court must set forth the specific conduct that implicates Rule 9011 in this proceeding. Based upon the record, the court is concerned with apparent violations of Rule 9011 subsections (b)(1), (2) and (3). Accordingly, the court will address each separately.

A. "Improper Purpose"

The Debtor argues that the Plaintiff commenced the adversary proceeding for improper purposes – harassment and unnecessarily driving up the cost of obtaining bankruptcy relief. Based upon the bizarre nature of the allegations and the uncharacteristic conduct of the Plaintiff's counsel in advocating what appears to be an entirely baseless position, the court agrees. The Plaintiff, through its counsel, is becoming a familiar presence in this court. While the court is mindful of the potential "chilling effect" that Rule 9011 may have on litigants, including the Plaintiff, it cannot ignore the inference that the Plaintiff's particularly aggressive tactics in this case are being used for the improper purposes of intimidating the Debtor into settlement of the adversary proceeding, harassment, or to send a threatening message to its customers who may become debtors in the future. Such conduct is not tolerable, especially when the court considers what may have happened if the Debtor had not been represented by equally aggressive counsel. As is required by Rule 9011, further proceedings are warranted on this issue to provide the Plaintiff and its counsel with an opportunity to show cause why they have not violated Rule 9011(b)(1).

B. "Existing Law or Good Faith"

Under Rule 9011(b)(2), an attorney has an affirmative duty to conduct a reasonable inquiry to assure that the claims being made are meritorious and worthy of pursuit. Because "violations of Rule 9011 are determined by applying the objective standard of reasonableness under the circumstances," *Id.* at 633

(citations omitted); *In re Glaser,* 49 B.R. 1015, 1021 (S.D.N.Y. 1985) (citing *Eastway Construction Corp. V. City of New York,* 762 F.2d 243, 253-254 (2d Cir. 1985)), the court must ask whether another attorney, after reasonable inquiry, would have refused to file the Complaint at issue in this proceeding, because it was either "frivolous" or "destined to fail." *Eastway,* 762 F.2d at 254. In the Second Circuit, this objective standard is met only where "it is patently clear that a claim has absolutely no chance of success under the existing precedents, and where no reasonable argument can be advanced to extend, modify or reverse the law as it stands." *Id.* Thus, in order to proceed under the second prong of Rule 9011(b), the court must first examine the Plaintiff's burden of proof under Code § 727(a)(4)(A), which constituted the Plaintiff's sole cause of action against the Debtor.

The Plaintiff alleged, mainly, that because the Debtor had allegedly failed to schedule the income or expenses of his fiancee, it was "obvious the design of the Debtor [was] to incur expenses for a third party with whom he resides, discharge that obligation, and conceal the corresponding income received as well as his true financial circumstances" (*Id.* ¶¶ 17, 21).

Code § 727(a)(4)(A) provides that the court shall grant the debtor a discharge, "unless the debtor knowingly and fraudulently, in or in connection with the case, made a false oath or account." In order to have prevailed on this cause of action, the Plaintiff must have established the following elements: (1) the debtor made a statement under oath; (2) such statement was false; (3) the debtor knew the statement was false; (4) the debtor made the statement with fraudulent intent; and (5) the statement related materially to the bankruptcy case. *In re Frommann,* 153 B.R. 113, 118 (Bankr. E.D.N.Y. 1993).

Under the Plaintiff's first legal theory, the Debtor allegedly committed fraud by intentionally failing to disclose his fiancee's income in his Petition. Consequently, the relevant question for purposes of a Rule 9011(b)(2) determination is whether this admitted non-disclosure could meet the legal requirements for fraud so as to render the Complaint warranted by existing law. The court can find no authority, within this Circuit or otherwise, for including a fiancee's income on a debtor's schedules when the debtor files an individual

Chapter 7 petition for relief. *See In re Bezoza,* 271 B.R. 46, 52 (Bankr. S.D.N.Y. 2002) (a court, in fixing support or judging ability to pay, may consider certain financial resources that are *not* available to creditors either inside or outside bankruptcy, including the resources of a live-in paramour) (emphasis added). The court is also cognizant of the Plaintiff's failure to produce any case law addressing this issue.

Under the Plaintiff's second legal theory, the Complaint was warranted by the Debtor's supposed failure to list certain transfers of assets to his fiancee prior to filing for bankruptcy. Specifically, at the 2004 Examination, the Plaintiff took issue with the following pre-bankruptcy expenditures by the Debtor: (1) $2,000, which he received from the sale of a 1971 Ford Mustang, and used to pay for a septic system at his current residence; and (2) an unspecified amount contributed monthly towards the automobile payment for an automobile which he owns, but his fiancee primarily drives. While the Plaintiff cites *Williamson* in support of its position that these alleged omissions and transfers are sufficient to warrant relief under Code § 727(a)(4)(A), no reading of the facts in this case could bring the Debtor within the purview of that court's holdings. In that case, the bankruptcy court found that the debtor had made three false oaths: (1) the debtor listed two personal bank accounts on his Statement of Financial Affairs, but failed to list a third account that he maintained with his fiancee during the relevant time period and that he had made a number of deposits into; (2) he failed to list at least three monetary gifts that he had made to his fiancee during the preference period; and (3) at the debtor's Rule 2004 examination, he testified under oath that he had withdrawn $15,000 from one of his bank accounts and used the money to repay a loan from his brother when in fact he had given the money to his fiancee to pay her divorce lawyer. *Williamson,* 828 F.2d at 251. In addition, the bankruptcy court found that the debtor fraudulently transferred property prior to filing for bankruptcy. Here, the Debtor disclosed his joint checking account with his fiancee, as well as his use of the 2002 tax return for "everyday living expenses." Hence, the court must ask the proverbial question with respect to the Plaintiff's reliance on *Williamson*, "How do we get there from here?"

In this case, the Plaintiff sought to deny the general discharge of a debtor who earned gross income

of $17,987 in 2002 and expected to earn gross income of $9,000 in 2003 (Debtor's Statement of Financial Affairs ¶ 1), received unemployment benefits during the period of 2002-2003 (*Id.* ¶ 2), and had unsecured liabilities of $21,402.63. The Debtor retained competent counsel to advise him in the filing of the Petition and, despite the best arguments of the Plaintiff to the contrary, disclosed all required information, including a workers compensation case, the receipt of $343 in November 2002 from a closed retirement account, the receipt and specific use of the $2,000, and the existence of his joint bank account with his fiancee.

Based upon the Petition and the Debtor's testimony at the 2004 Examination, which the Plaintiff has not discredited, it appears that the Complaint was not factually or legally well-grounded, and that upon any responsible reflection of the facts elicited, it should have been obvious that no fraudulent intent attended the filing of the Petition. Under these circumstances, the Plaintiff's claim seemingly meets the definition of a "frivolous" claim. *See* BLACK'S LAW DICTIONARY 668 (6th ed. 1990) ("A claim or defense is frivolous if a proponent can present no rational argument based on the evidence or law in support of that claim or defense."). Because it appears that the Plaintiff and its counsel failed to adequately investigate and research the basis for filing the Complaint, further inquiry is necessary to determine whether sanctions are warranted under Rule 9011(b)(2).

C. "Evidentiary Support"

At the hearing held on May 6, 2004, Mr. Antonucci advised the court that the Plaintiff's "problem" in this case was that it had to compare "apples to oranges" because the Debtor did not provide a full accounting of his income or expenses, but instead included some joint expenses on his Schedule "J" while neglecting to account for miscellaneous "income" provided to him by his fiancee. He continued to state that the Plaintiff is "entitled to a bigger, better picture." After reviewing the transcript of the 2004 Examination, however, the court is perplexed as to what additional information the Debtor could have provided. At the

2004 Examination, the following exchanges took place between Mr. Antonucci and the Debtor:[5]

> Q: Where do you currently reside?
> *A: Sacketts Harbor.*
> Q: Could you be more specific with me?
> *A: Burton Road.*
> Q: Who do you reside at that address with?
> *A: My fiancee.*
> . . . .
> Q: I'm going to show you Schedule J to your bankruptcy petition and represent to you it's a copy of what was actually filed with the court. Do you recall seeing that document before?
> *A: Yes.*
> Q: There's an electricity and heating fuel cost or expense listed in that schedule; do you see that?
> *A: Yes.*
> Q: Is that for the Burton Road house?
> *A: Yes.*
> Q: Is that the total utility for the house each month?
> *A: That would be my portion.*
> Q: How much is your portion of the overall bill?
> *A: 50 percent.*
> . . . .
> Q: Do you pay those bills directly, or do you give the money to your fiancee?
> *A: I don't pay that directly.*
> Q: Do you give it to her in cash or by check?
> *A: Direct deposit into a checking account.*
> Q: So your payroll is directly deposited into an account of hers?
> *A: Both of ours.*
> . . . .
> Q: And are all your expenses proportionate with hers in this schedule the way you share the fuel oil and the electricity?
> *A: Yes.*
> Q: And they're all divided 50/50 between the two of you?
> *A: Yes.*
> . . . .
> Q: Have you managed to pay [the expenses on Schedule J] as they've come due for the past year?
> *A: Yes.*
> . . . .
> Q: Am I correct in concluding that Schedule I shows that you have net income each month of $858.10?
> *A: Yes.*
> Q: Can you tell me how, with $858.10 in income each month, you've managed to consistently pay expenses of nearly double that as listed on Exhibit 2?
> *A: This is all split. She helps out, my fiancee, with meeting the bills.*
> . . . .

[5] The court refers to the transcript of the 2004 Examination which was attached as Exhibit C to the Debtor's Motion to Dismiss Adversary Complaint, Dkt. No. 9.

Q: Would it be fair to say that you pool your income and expenses with respect to all financial matters?
A: Yes.
Q: Do you maintain any other bank accounts, either jointly or alone, besides the Watertown Savings Bank account you mentioned?
A: No.

(Tr. at 9 - 20.) Mr. Antonucci continued to question the Debtor about his 2002 tax return and the $2,000 used by the Debtor to pay for the septic system. All responses given by the Debtor, including those set forth above, were consistent with those provided in the Petition.

Moreover, the Debtor testified that he neither received any unreported "income" from his fiancee nor did he gift any property to her prior to filing his Petition. On several occasions, the Debtor testified that Schedule "J" lists only his one-half share of the household expenses. Further, examination of the Debtor's Schedule "J" suggests that the Debtor's expenses may even be underestimated; the Debtor reports $0 for monthly rent or mortgage payments, which does not take into account the obvious fact that his fiancee gratuitously allows him to live in her home; his total food budget is only $200 per month; he reports only $50 per month in medical expenses, although he lists $0 for health insurance; and he lists $433 per month as an income deduction, although he stated at the 2004 Examination that his child support obligation would be increasing because of an hourly $2 pay increase obtained since the filing of his Petition (2004 Examination Tr. at 7).

As detailed herein, it presently appears to the court that the Plaintiff's fraud claim and legal contentions were without evidentiary support when filed and, as is clear from the transcript of the 2004 Examination, were without evidentiary support even after further investigation. Therefore, pursuant to the procedural devices of Rule 9011(c)(1)(B), further proceedings are required to determine whether sanctions are warranted under Rule 9011(b)(3).

II. 11 U.S.C. § 105

Finally, the court has an additional means at its disposal for sanctioning improper conduct – its inherent power under Code § 105. This section provides that "the court may issue any order, process, or

judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a).

Under standards well-established in the Second Circuit, the court's inherent power must be exercised with restraint and utilized only when the challenged conduct is "entirely without color" and "motivated by improper purposes." *In re Butler,* 260 B.R. at 635 (citing *Milltex Industries Corp. v. Jacquard Lace Co., LTD*, 55 F.3d 34, 35 (2d. Cir. 1995); *In re 72nd Street Realty Associates,* 185 B.R. 460, 475 (Bankr. S.D.N.Y. 1995) ("A court is empowered to assess costs and fees against an attorney and/or his client where a party acts in bad faith, vexatiously, wantonly or for oppressive reasons."). For the reasons more fully detailed above, based on the totality of the circumstances, it appears that this standard is also met in this case. The Plaintiff and its counsel, therefore, must be provided the opportunity to prove otherwise.

Conclusion

Based on the foregoing, the Plaintiff is directed to show cause why it should not be sanctioned pursuant to Code § 105. Counsel for the Plaintiff is also directed to show cause why he should not be sanctioned as the moving attorney pursuant to Rule 9011(b)(1), (2) and (3), and Code § 105. In accordance with this Memorandum-Decision and Order,

IT IS HEREBY ORDERED that Plaintiff and its counsel, David Antonucci, shall appear on **Tuesday, September 14, 2004, at 11:00 AM** at the United States Bankruptcy Court for the Northern District of New York, James T. Foley U.S. Courthouse, 445 Broadway, Room 306, and SHOW CAUSE why they should not be sanctioned, for the reasons set forth herein, pursuant to Rule 9011 and Code § 105.

It is so ORDERED.

Dated: July 27, 2004
Albany, New York

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Hon. Robert E. Littlefield, Jr.
United States Bankruptcy Court